

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 AID-05 CEA-01 CIAE-00 COME-00 EB-08
EA-10 FRB-03 INR-07 IO-13 NEA-10 NSAE-00 USIA-06
OPIC-03 SP-02 TRSE-00 LAB-04 SIL-01 AGRE-00
OMB-01 SS-15 NSC-05 STR-04 PA-01 PRS-01 DOTE-00
EPA-01 HUD-01 HEW-04 /119 W
-----022238 232050Z /72

R 231625Z AUG 77
FM AMEMBASSY MADRID
TO SECSTATE WASHDC 1469
INFO AMEMBASSY BONN
AMEMBASSY LISBON
AMEMBASSY LONDON
AMEMBASSY PARIS
AMEMBASSY ROME

C O N F I D E N T I A L SECTION 1 OF 2 MADRID 6255

USOECD

E.O.11652: GDS
TAGS: ECON, PINT, EFIN, SP
SUBJECT: SPAIN'S ECONOMIC PROGRAM COMMENTS OF ECON MINISTRY SUB
SECRETARY

REF: MADRID 5632 AND 5887 (BOTH NOTAL)

1. SUMMARY. NEW UNDER SECRETARY OF MINISTRY OF
ECONOMY HOPEFUL GOVERNMENT'S IMPLEMENTATION OF
ECONOMIC PROGRAM WILL BEGIN TO MODERATE INFLATION
AND BALANCE OF PAYMENTS DEFICIT THIS YEAR AND
MAKE FURTHER PROGRESS IN 1978, ALTHOUGH COMPLETE
SUCCESS IN GOVERNMENT'S EFFORT TO DEAL SIMULTANEOUSLY
WITH CURRENT AND STRUCTURAL PROBLEMS WILL TAKE
LONGER. KEY TO CHECKING INFLATION WILL BE ACHIEVING
AGREEMENT OF LABOR LEADERS AND BUSINESSMEN TO
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MODERATION IN WAGE SETTLEMENTS. FISCAL REFORM WILL
EVENTUALLY ALLOW NON-INFLATIONARY INCREASE IN PUBLIC
EXPENDITURES AND REMOVE BURDEN ON PRIVATE SECTOR TO
FINANCE ESSENTIAL SOCIAL SERVICES. AT SAME TIME, GOVERN-
MENT IS PROCEEDING WITH STRUCTURAL REFORMS TO INCREASE
INFLUENCE OF MARKET FORCES IN ECONOMY, PARTICULARLY IN
BANKING SYSTEM. SPAIN IS HOPEFUL WELL FORMULATED AND

EXECUTED ECONOMIC PROGRAM WILL ENCOURAGE INTERNATIONAL SUPPORT. END SUMMARY.

2. DURING AUGUST 22 COURTESY CALL BY DCM AND EMBASSY OFFICER, NEW UNDER SECRETARY OF ECONOMY MINISTRY, MAUEL JESUS LAGARES, PROVIDED TOUR D'HORIZON OF CURRENT GOVERNMENT EFFORTS IN IMPLEMENTATION OF ECONOMIC PROGRAM. LAGARES CONFIRMED EMBASSY'S UNDERSTANDING THAT MINISTRY OF ECONOMY WILL HAVE OVERALL DIRECTION OF SPANISH ECONOMY WITH THREE MAIN DEPARTMENTS DEALING WITH FINANCIAL POLICY (INCLUDING BANK OF SPAIN AND BANKING SYSTEM AS A WHOLE), ECONOMIC PLANNING, AND STATISTICS (MADRID 5137). MINISTRY OF FINANCE WILL BE LIMITED TO BUDGET, TAXATION, AND PUBLIC EXPENDITURE. INTER-MINISTRIAL COORDINATION ON ECONOMIC POLICY WILL BE MAINTAINED THROUGH ECONOMIC COMMISSION HEADED BY VICE PRESIDENT FOR ECONOMIC AFFAIRS AND MINISTER OF ECONOMY FUENTES QUINTANA. THIS COMMISSION HAS BEEN OR WILL BE EXPANDED TO INCLUDE MINISTER OF PUBLIC WORKS AND COMMUNICATIONS AS WELL AS MINISTERS OF ECONOMY, FINANCE, AGRICULTURE, COMMERCE AND TOURISM, TRANSPORTATION, AND INDUSTRY AND ENERGY.

3. LAGARES SAID THAT GOVERNMENT EXPECTS "FIRST STAGE" OF ITS ECONOMIC PROGRAM TO BE COMPLETED AROUND THE END OF 1978, ALTHOUGH THERE WILL STILL BE MUCH TO BE DONE THEREAFTER. IMMEDIATE GOAL IS TO REDUCE RATE OF IN-
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FLATION, WHICH LAGARES ESTIMATES COULD REACH 25 PERCENT THIS YEAR AND MORE THAN 30 PERCENT NEXT YEAR, "ACCELERATING THEREAFTER IN A LATIN AMERICAN PATTERN" IF CORRECTIVE MEASURES ARE NOT TAKEN. CONSEQUENTLY MONETARY POLICY IS BEING MADE MORE RESTRICTIVE, BUT GRADUALLY SO AS NOT TO BE TOO UNSETTLING. EXACT DEGREE OF RESTRAINT NOT YET DECIDED AND WILL DEPEND ON WAGE NEGOTIATIONS. (SEPARATELY, THE DIRECTOR GENERAL OF FINANCIAL POLICY IN THE MINISTRY OF ECONOMY, JUAN JOSE TORIBIO, TOLD AN EMBASSY OFFICER THAT THE GOVERNMENT WAS THINKING OF A REDUCTION OF THE RATE OF INCREASE OF MONEY SUPPLY FROM 21PERCENT TO 18 PERCENT BY THE END OF THE YEAR. (HE ALSO SAID THERE HAD BEEN A SURGE IN COST OF LIVING DURING JULY BEYOND THE 13.4 PERCENT INCREASE FOR THE FIRST SIX MONTHS OF THIS YEAR.) KEY TO SUCCESS IN REDUCTION OF RATE OF INFLATION LAGARES BELIEVES IN ACHIEVING RESTRAINT ON WAGE INCREASES. TO THIS END AN INTER-MINISTERIAL GROUP HEADED BY SECRETARY OF STATE FOR COORDINATION AND ECONOMIC PROGRAMMING ALVAREZ RENDUELES WILL MEET AUGUST 23 (MADRID 6187) WITH REPRESENTATIVES OF THREE MAJOR UNIONS (SOCIALIST UGT, COMMUNIST SWC, AND CHRISTIAN SOCIALIST USO) AND AUGUST 24 WITH EMPLOYERS CONFEDERATIONS TO STRESS IMPORTANCE OF RESTRAINT IN WAGE SETTLEMENTS IF

GOVERNMENT IS TO AVOID MONEY
SUPPLY POLICY HAVING UNDULY ADVERSE EFFECT ON EMPLOYMENT AND
VIABILITY OF PRIVATE FIRMS. AND IS TO PROCEED WITH PLANS FOR
EXPANDING GOVERNMENT SERVICES. DISCUSSIONS LATER
MAY BE EXPANDED TO INCLUDE BASQUE STV AND CNT.

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C O N F I D E N T I A L SECTION 2 OF 2 MADRID 6255

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4. IN ADDITION TO MONETARY AND INCOMES POLICES,
LAGARES SAID THAT THE GOVERNMENT IS DETERMINED TO
PROCEED WITH FISCAL REFORM, EVENTUALLY GOING SUBSTANTIALLY
FURTHER THAN PROGRAM THIS FAR PRESENTED TO PARLIAMENT
BY MINISTER OF FINANCE. INITIAL TAX REFORMS BEING
PROPOSED ARE MODERATE, BUT ESSENTIAL TO BEGIN MORE
SWEEPING FISCAL REFORM TO ALLOW INCREASE IN GOVERNMENT
EXPENDITURES FOR ESSENTIAL SOCIAL SERVICES (EDUCATION,
HEALTH, PUBLIC HOUSING, AND SOCIAL SECURITY) THE COST

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OF WHICH IS NOW AN INORDINATE BURDEN ON THE PRIVATE SECTOR.

5. WHILE IMPLEMENTING ANTI-INFLATIONARY MEASURES, LAGARES SAID GOVERNMENT IS PROCEEDING WITH STRUCTURAL REFORMS TO INCREASE PLAY OF FREE MARKET FORCES IN THE MONETARY SYSTEM. INTEREST RATES ON CREDITS OF OVER ONE YEAR HAVE ALREADY BEEN LIBERALIZED, AND AIM IS FOR EVENTUAL ELIMINATION OF ALL INTEREST CONTROLS. IN THE SAME LIBERALIZING VEIN, THE GOVERNMENT IS GRADUALLY REDUCING COEFFICIENTS OF INVESTMENT WHICH REQUIRE CREDIT INSTITUTIONS TO DIRECT LOANS FOR SPECIFIED SECTORS OR PURPOSES. MOREOVER INCREASED COMPETITION AMONG FINANCIAL INSTITUTIONS WILL BE ENCOURAGED AND MORE FOREIGN COMMERCIAL BANKS WILL BE PERMITTED IN DUE COURSE.

6. RATHER THAN INSTITUTING CONTROLS, LAGARES SAID THE GOVERNMENT IS RELYING ON REALISTIC EXCHANGE RATE COMBINED WITH REDUCTION IN INFLATION TO GRADUALLY CORRECT EXTERNAL DISEQUILIBRIUM. HE EXPECTS THERE MAY BE SOME SLIGHT REDUCTION IN THE CURRENT ACCOUNT BALANCE OF PAYMENTS DEFICIT THIS YEAR COMPARED WITH LAST YEAR'S \$4.2 BILLION DEFICIT. MEANWHILE, THERE HAS BEEN SOME REFLOW OF CAPITAL AFTER THE DEVALUATION. IF THE GOVERNMENT IS SUCCESSFUL IN COMBATTING INFLATION, THERE SHOULD BE MORE IMPROVEMENT NEXT YEAR. WHILE LAGARES BELIEVES SPAIN WILL HAVE A CURRENT ACCOUNT DEFICIT FOR SOME YEARS TO COME, HE IS HOPEFUL THAT THE GOVERNMENT'S ECONOMIC PROGRAM WILL REDUCE IT TO A MANAGEABLE LEVEL.

7. IN CLOSING , LAGARES SAID SPAIN WILL BE COUNTING
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ON UNDERSTANDING AND SUPPORT OF OTHER COUNTRIES, PARTICULARLY THE U.S. THE DCM SAID PROGRAM LAGARES HAD OUTLINED SHOULD GENERATE SUPPORT IF SUCCESSFULLY IMPLEMENTED. DCM EMPHASIZED HOWEVER THAT IN TODAY'S WORLD PRINCIPAL SOURCES OF FINANCIAL SUPPORT WOULD BE INTERNATIONAL INSTITUTIONS (PARTICULARLY THE INF) AND PRIVATE SECTOR RATHER THAN GOVERNMENTS.

8. COMMENT: PROGRAM LAGARES OUTLINED IS SOUND IN ITS

GENERAL TERMS. PRINCIPAL QUESTIONS ARE (A) WHETHER
PACE ENVISAGED WILL BE ADEQUATE IN VIEW OF AVAILABLE
EXTERNAL FINANCING AND (B) WHETHER LABOR'S REACTION
TO PLANS FOR WAGE RESTRAINT AND BANKERS REACTION
TO MONETARY AND TAX REFORMS WILL PERMIT EVEN THE PACE
THAT IS ENVISAGED. ON THE POSITIVE SIDE, THE GOS
HAS A GOOD ECONOMIC TEAM AND THUS FAR SEEMS DETERMINED
TO IMPLEMENT A RESPONSIBLE PROGRAM. STABLER

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